G0175-1

American Banker

The Daily Financial Services N

VOL. CLII NO. 7 Monday, January 12, 1987

150222000015 8/15/05 C11
CONGRESSIONAL INFOR SREV SRI
ACQUIS EDITOR SRI
4520 E. WEST HIGHWAY
BETHESDA MD 20814

ear

TODAY

NEWS MONDAY

WEEKLY REVIEW AND OUTLOOK — Pull Out Section Starting on Page 9

INSIGHT: The issue of whether lenders should have to take part in mediation sessions before they can foreclose on financially troubled farmers is expected to heat up in the coming year... 9

INSIGHT — A Perspective on New Developments

Index of the Week's Top Stories... 16

People... 15

WASHINGTON WEEK

Pages 10-11

NEW FEATURE: Starting today, we are including in our regular calendar a new section called "Advance Notice." It will call attention to key meetings, hearings, and other events scheduled beyond the current week... 10

BRIEFING: In a joint announcement, the Federal Reserve, the Federal Deposit Insurance Corp., the Office of the Comptroller of the Currency, and the Bank of England unveiled a new plan designed to serve as a global model for capital standards... 10

An Insider's Guide To Capital Issues

HASTE MAKES WASTE: The new chairman of the Senate Budget Committee was so anxious to begin grilling the administration's budget director that he forgot to give the witness the opportunity to make an opening statement... 11

PNC INTERNATIONAL Bank plans to open a subsidiary bank in Paris... 2

CONSUMERS PREFER to use cash and checks over credit cards and electronic funds transfers, a recent survey says... 3

TOP TALENT and commitment are as important as capital for a new bank to succeed, writes Dr. Paul S. Nadler... 4

PRESIDENT REAGAN has failed with respect to financing the federal establishment, says H. Erich Heinemann... 4

ONE OF THE FIRST 1987 bank failures, Security National Bank & Trust Co., has been acquired by two Arkansas bank holding companies... 17

'86 preview '87

BANKS WILL BE LOOKING to noninterest sources to boost earnings in 1987... 24

Executive Changes... 6
In the News... 3
Memory Bank... 4

The Battle Lines In the Fight Over Those Card Rates

Levels Are Justified, Banks Say; Consumer Groups Cry Greed

By PHILIP T. SUDO

NEW YORK — The argument over interest rates on bank credit cards — specifically, whether they are too high — has divided consumers and bankers ever since states began deregulating their usury ceilings.

News Analysis

Up until now, the debate has been sporadic. Last Thursday, however, a coalition of the country's largest consumer groups announced the launching of a nationwide campaign to bring down rates, catching the attention of both bankers and legislators.

Ironically, the "fight and switch" campaign begins at a time when many banks have begun voluntarily to inch their rates downward. Nonetheless, the group said, it will encourage card holders to shop for better prices and services, and seek legislative remedies in the area of disclosure and possibly rate ceilings.

What follows is a look at some of the key questions in the debate:

• **Are banks making an unreasonable profit?** There is no doubt that the high rates have been profitable. In 1985, credit card earnings delivered a 5% return on assets, when a 1% ROA was considered good for a bank's entire operations.

As a result, representatives from the consumer coalition argue that banks are "gouging" consumers with annual fees and rates that are exorbitantly high. A 19.8% rate today is typical at most major banks, and the figure runs as high as 21% at firms such as the First Interstate Bank of California — despite the fact that the cost of funds has plummeted during the last few years to

Cards: Page 21 ➡

US Banks Seek Equal Treatment As Capital Talks Move to Japan

By GORDON MATTHEWS and BARTLETT NAYLOR

Bankers and financial industry observers greeted the proposed joint capital guidelines of the Federal Reserve Board and the Bank of England as a positive step, but other banks and nonbanking competitors, they said, must be within the same framework to insure competitive equality.

Meanwhile, E. Gerald Corrigan, president of the Federal Reserve Bank of New York, was reportedly discussing capital adequacy ratios with central banking officials in Japan, whose major banks have long operated with lower capital levels than those of many of the their international competitors.

"It's a step in the right direction," said Donald B. Riefler, chairman of the sources and uses of funds committee of the Morgan Guaranty Trust Co., New York. "We're very much in favor of risk-based capital [regulation] as an alternative to the current method."

The Fed proposed guidelines last Thursday that would for the first time require the off-balance-sheet items of banks to be backed by capital. It was joined by the Bank of England in proposing that bank capital be gauged by the risks against it and by a standard definition of primary capital.

"If applied flexibly, this can't help but be beneficial," said Robert P. Shay, professor of finance at Columbia University's school of business. "But I think it's essential that the Japanese be brought in as well."

Capital: Page 2 ➡

Much Ado About British Deregulation

Some Question Whether '87 Profits Will Justify the Big Bang Hoopla

By JOHN J. DUFFY
London Bureau

LONDON — The sweeping Big Bang deregulation of Britain's securities markets, plus another surge in Eurobond activity, made London the most active of the world's financial centers in 1986.

At yearend, however, many bankers and market experts here were questioning whether profits from such activity in 1987 will justify all the hoopla.

Big Bang, of course, was the most visible international financial event of 1986. The Oct. 27 abolition of fixed commissions on the London Stock Exchange and the elimination of the barrier between brokers and market makers brought a huge number of new players onto the international scene.

Merrill Lynch & Co. became a member of the stock exchange. Morgan Guaranty Trust Co. of New York and Bankers Trust Co., as well as other U.S. banks, became primary dealers in British government bonds, or gilts.

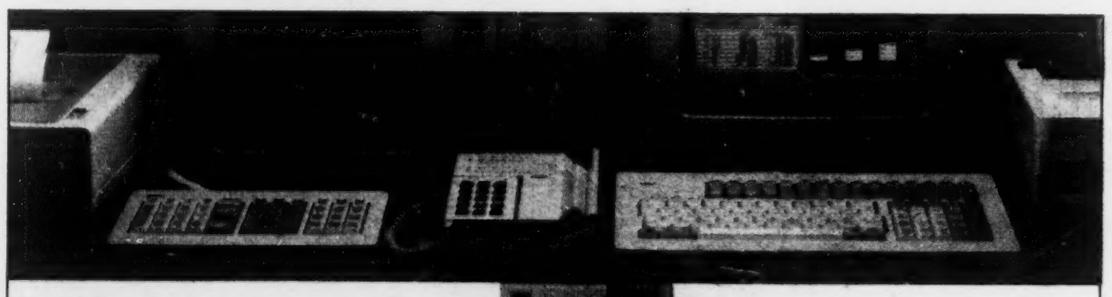
'86 preview '87

A Series of Articles Looking Back and Ahead At Issues Facing the Financial Services Industry

However, the sharp increase in competition in the aftermath of Big Bang has not left the smaller players by the wayside yet as several analysts had predicted that it would.

In fact, the only catastrophe so far

London Review: Page 2 ➡



THE FIRST OPEN PLATFORM FOR BRANCH AUTOMATION.

Only one branch automation system is built around industry standards to protect your organization from obsolescence. The Financial Tower™ System.

For complete information phone 1-800-CALL NCR.

NCR

Financial Tower is a trademark of NCR Corporation.

© 1986 NCR Corporation.

Find The SILVER LINING Of Service Fee Income Through Supplemental Insurance

• Life
• Accident
• Hospital Cash Benefit

Attractive Protection For Your Customers...
Bottom Line Profit For You!
Call Today For Details

The Credit Life Companies of Springfield

One South Limestone Street
Springfield, Ohio 45502
(513) 328-2200

Capital . . .

➳ Continued from Page 1

He noted that the effort "doesn't mean common requirements, but a common approach. I wouldn't want to see the standards get too detailed or [see] too much of straitjacket placed on banks, because I think there are differences in management that can tolerate different degrees of risk."

He expressed some concern that the requirements, even if flexible, might put banks at some disadvantage vis-a-vis their nonbanking competitors. That was a principal concern of Mr. Riefler at Morgan Guaranty and of other bankers as well.

"The whole procedure has difficulties," said Mr. Riefler, "because a lot of institutions have not come under these rules. We're glad to see British banks brought in, but you could look beyond them to the German, French, and Japanese banks, and then to the investment bankers, the insurance firms, the securities firms, and the nonbank banks."

A banking analyst, Thomas K. Brown of Smith Barney, Harris Upham & Co., agreed that "all banks applaud the move to more risk-adjusted capital but then ask when do you start regulating the securities firms. A lot of their business is the same, and there are no capital requirements per se on brokerage firms."

Mr. Brown said he felt the coordination between different countries in matters of capital is a major breakthrough. "It would be significant even without Japan, but with the Japanese it would be a very powerful move indeed," he emphasized.

Anthony Saunders, associate professor of finance at New York University, said the "long overdue" move by the two central banks addresses "the big question of bringing the risk of the off-balance-sheet business under control with sufficient bank capital to meet losses on those activities."

"The whole idea of risk-related capital adequacy is very good concept," he said, "and if the regulators now move toward risk-related deposit insurance premiums, we will have gone a long way to controlling risk in banking."

Jonathan H. Francis of Wharton Econometrics Associates, Philadelphia, said the move amounted to recognition that "banking has become a global industry," and that more information about its activities is needed.

"In other circumstances, such as the Latin debt crisis, the fact that we didn't have enough information on the exposure of the banks was one of the big factors that precipitated a crisis and made it worse."

He applauded moves toward "a general regulatory framework where we will have a consistent picture of banks' balance sheets and the risks associated with those balances sheets. There have been many banking developments, particularly relating to off-balance-sheet items that have a risk profile that is largely unknown. ■

Corrections

An *American Banker* article on Jan. 6 ("NY Banking Chief Calls New Ruling 'Nudge, Not a Challenge' to the Fed," page 1) incorrectly characterized the New York State Banking Department's stand on the Hongkong and Shanghai Banking Corp.'s 1979 investment in Marine Midland Banks Inc. The New York banking department opposed the takeover, causing Marine Midland to seek a national charter for its principal bank.

□

Also on Jan. 6, First Hawaiian Creditcorp was identified incorrectly as the parent of First Hawaiian Bank ("In the News," page 3). First Hawaiian Inc. is the parent of the First Hawaiian Bank, the second largest financial institution in Hawaii. ■

How Big Was the 1986 Bang in British Finance?

➳ Continued from Page 1

has been the exchange's own computerized quotation system, the Stock Exchange Automated Quotation System, or SEAQ, which has crashed repeatedly under the weight of rising trading volumes.

The effect of Big Bang on trading was generally as expected. Trading volume rose by nearly 30% in stocks and nearly doubled in gilts, while the costs of transactions plunged 30%, to 50%.

'86 preview '87

A Series of Articles Looking Back and Ahead At Issues Facing the Financial Services Industry

The most dramatic illustration of the change wrought in the markets by Big Bang was the exchange floor itself on the day before Christmas Eve.

Where in previous years traders stood shoulder to shoulder conducting business and holiday celebrations at the same time, this year the floor was deserted. Trading had moved "upstairs" to the dealers' own high-technology trading rooms, leaving only a few old-timers on the floor to exchange shares and Christmas greetings.

The effect of Big Bang on profits has been more difficult to gauge, and many firms admit that it will be years before they can recoup totally the huge amounts spent on people and systems.

"People have not yet begun to focus completely on the bottom line," one dealer said. "That will come in 1987 or later."

For the Eurobond market, the other major market centered in London, 1986 was also a vintage year. Total funds raised in the market last year surged to a record $183.8 billion, up 36% from $133 billion in 1985 and more than double $80 billion in 1984.

In 1986, Eurobond market volume topped international syndicated loan volume for the first time. Such loans last year totaled $174.7 billion.

Despite the astounding numbers, many market experts are cautious about the future of the Eurobond market.

"The volume in 1986 probably represents a cyclical high," said Ben Weston, the managing director and head of capital markets at Bankers Trust International. Because of a slackening in demand for funds and a probable halt in the decline in interest rates, volume in 1987 could fall to around $150 billion or so, Mr. Weston said.

In addition, U.S. banks and securities firms are facing greater competitive pressure because of a decline in the amount of financing done in U.S. dollars.

In 1986, because of the year-long decline in the value of the U.S. dollar, that currency's share of the Eurobond market dropped from 70% to 63%, while the market share of the yen doubled from 5% to 10%. This trend is expected to continue in 1987.

The shift to the yen helped to push five Japanese banks and securities firms into the top 20 major Eurobond underwriters — and to push U.S. banks, such as Bankers Trust, out of the top 20.

"It's critical that U.S. banks get more involved in foreign currency markets," said Mr. Weston.

In 1986, Morgan Guaranty remained the only U.S. commercial bank to figure prominently in the Eurobond market. According to the *International Financing Review*, a weekly Euromarket magazine, Morgan ranked fourth among all underwriters last year, with a 5.35% market share.

The leader was Credit Suisse First Boston, with a 10.68% share; followed by Nomura Securities, with 7.97%; and Deutsche Bank, with 6.75%. The only other U.S. bank near the top was Bankers Trust, which came in 22d, with a 1.36% market share.

The Eurobond market grew intensely competitive in 1986, and, as opposed to the British securities market following Big Bang, competition did cause several smaller operators, such as First Interstate Capital Markets, to pull out completely. Experts say that more small and medium-size firms will come to the same decision in 1987.

"There are too many people trying to do too many things," said David Band, a managing director at Morgan Guaranty.

In 1987, Mr. Band said, more business will be concentrated among the top firms, particularly those that are strong in nondollar markets. Those without a particular niche to fill probably will pack up and go home, he said.

U.S. Bank Leaders in Euromarket

Eurobond Underwriting (Lead Manager Only)

	No. of Issues	Amount ($ Mil.)	Market Share	Rank Among Top 60 Underwriters
1. Morgan Guaranty	65	$9,800	5.35	4
2. Bankers Trust	20	$2,500	1.36	22
3. Chase Manhattan	15	$2,100	1.16	25
4. Citicorp	8	783	0.43	40
5. BankAmerica	11	700	0.38	41
6. Chemical	6	634	0.35	43
7. Manufacturers Hanover	7	560	0.31	46

International Syndicated Loans

	Loan Volume ($ Bil.)	No. of Lead-Managed Loans	Rank Among Top 50 Worldwide
1. Citicorp	$33.24	63	1
2. Morgan Guaranty	24.89	40	5
3. Chase Manhattan	24.81	76	6
4. Bankers Trust	24.37	47	7
5. BankAmerica	22.44	45	9
6. Manufacturers Hanover	22.14	28	10
7. Chemical	19.91	28	14
8. Security Pacific	19.37	16	15
9. First Chicago	19.15	46	16

Euro-Commercial Paper

	No. of Dealerships	Rank Among Top 36
1. Citicorp	64	1
2. Chase Manhattan	29	9
3. Bankers Trust	21	12
4. BankAmerica	16	14
5. Manufacturers Hanover	8	17
6. Security Pacific	3	33
7. Continental Illinois	2	36

Source: International Financing Review.

Still Holding in Short-Term Credit

While U.S. banks continued to have little success in Eurobonds in 1986, most continued to show their prowess with short-term credit instruments and traditional syndicated lending.

In Eurocommercial paper, for example, five U.S. banks — Citibank, Chase Manhattan, Bankers Trust, Bank of America, and Manufacturers Hanover — rank among the top 20 dealers. In international syndicated loans, U.S.

London Review: Page 23 ➳

PNC to Open Bank Subsidiary in Paris

By A. JOSEPH NEWMAN JR.

PHILADELPHIA — The PNC International Bank, a unit of the $21 billion-asset PNC Financial Corp., Pittsburgh, is planning to open a subsidiary bank in Paris, subject to approval of the Bank of France and the Federal Reserve.

The new bank, PNC International Bank France, would be PNC International's first subsidiary bank in Europe. PNC has a merchant banking unit in Australia, PNC International Financial Services Ltd., and its PNC International Finance (Asia) Ltd. is a deposit-taking company in Hong Kong.

Top officials of the new Paris bank have not been named yet. The institution will do a wholesale business only.

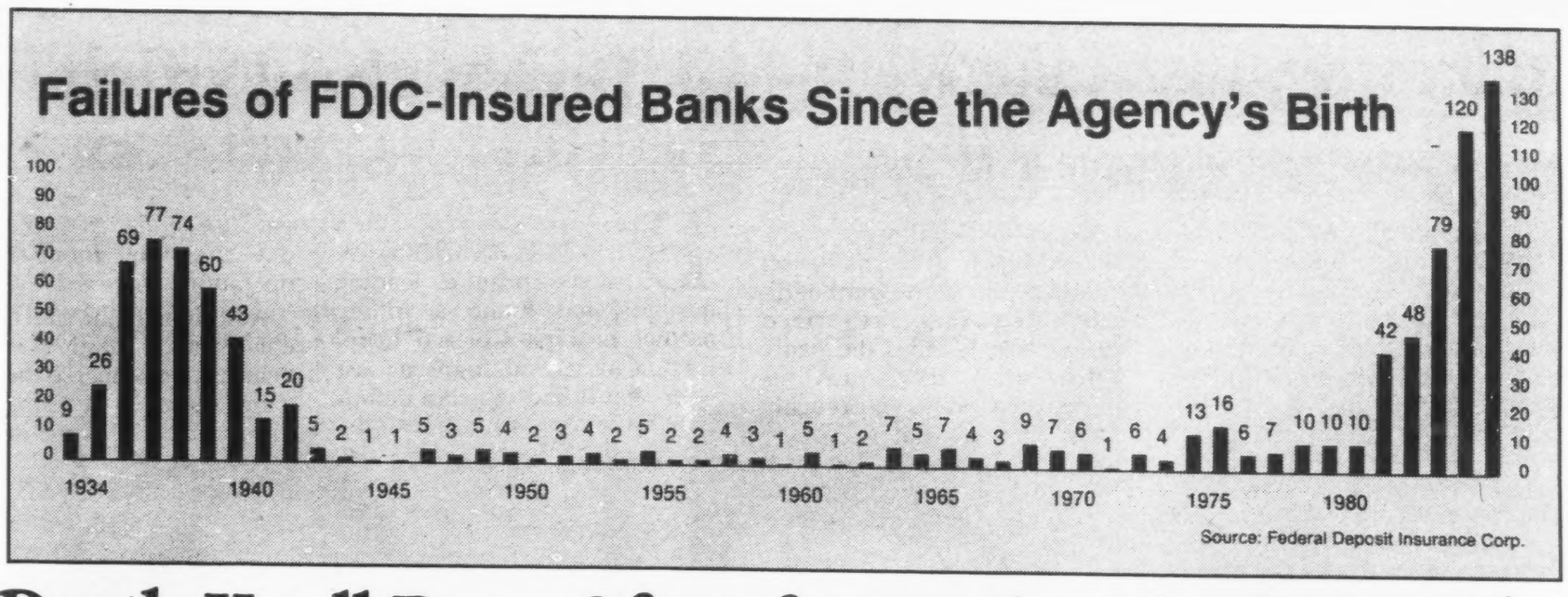
PNC International Bank now operates finance company subsidiaries in Italy under the name of PNC International Italy SpA, Milan, and it also has companies in Argentina and Brazil.

Edward J. Casselle, vice president and general manager of the Philadelphia office of PNC International, said the Pittsburgh National Bank branch and the European representative office of PNC International in Paris would continue to operate.

Mr. Casselle said that a full banking license in France would enable PNC International to diversify funding there through the French and Eurobank markets. A bank, he added, also offers tax advantages. In addition, PNC International plans to open a leasing company subsidiary in Paris.

The proposed new bank in Paris was announced at a press briefing by PNC International in Philadelphia. PNC International is 75% owned by Pittsburgh National Bank and 25% owned by the Provident National Bank, Philadelphia, both units of PNC Financial Corp.

PNC International also announced that it has named Carol Groeschel, vice president and deputy manager of its finance company unit in Milan, vice president and manager of the European representative office in Paris. She succeeds Constance Bentzen, who becomes the manager of the Los Angeles office of PNC International. ■



Death Knell Rang Often for Banks, Thrifts in '86

The Grim Reaper paid 138 house calls for the Federal Deposit Insurance Corp. last year as a record number of federally insured banks were closed. The Federal Savings and Loan Insurance Corp. also had need of the sinister gentleman's services, because thrifts were not spared their own toll in 1986.

Last year, the FDIC spent an estimated $2.7 billion, or 14%, of its $18.8 billion fund to close 138 insolvent banks and provide merger assistance to seven other failing institutions. It spent another $1.5 billion to settle the accounts of banks that failed before 1986.

The FSLIC began 1986 with an estimated $6.1 billion in reserves and ended it with about $2.2 billion after closing 21 insolvent institutions, providing merger assistance for 22, and placing 43 others in the management consignment program. Under that program, outside experts are brought in to attempt to reverse the financial fortunes of the troubled institutions.

The problems in the agricultural industry and the energy industry showed up clearly for banks in 1986, with most of the closed banks concentrated in the nation's midsection. Fifty-nine of the 138 closed banks were classified by the FDIC as farm banks, meaning that more than 25% of their total loans were agricultural loans.

The FDIC added the open-bank assistance option to its two main methods of dealing with a failure — arranging a merger by another bank or, more drastically, paying off depositors outright. If the agency determines that it would be less costly than a merger or payoff, it has the authority to provide assistance to an open bank. The FDIC used that authority seven times last year.

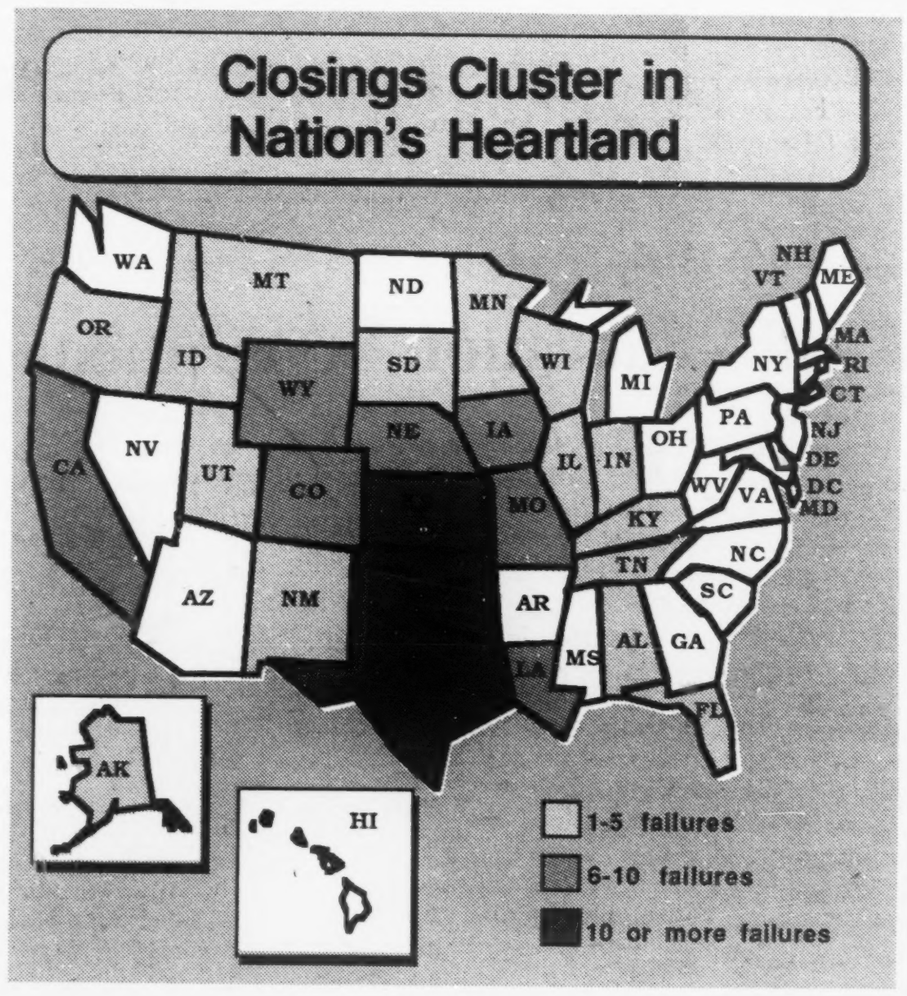
Although the FSLIC continued to use the management consignment program as a less-costly alternative in dealing with troubled thrifts, it still needs additional funding. New premiums this year from the S&L industry will bring reserves back above $4 billion, but regulators such as Federal Home Loan Bank Board Chairman Edwin J. Gray have claimed that this is hardly enough money to deal with some 500 troubled institutions. Closing troubled institutions in California alone could bankrupt the fund.

The recapitalization plan that failed in the last session of Congress would tap healthy institutions to raise about $25 billion long-term to cover closing costs for the sick ones.

How will 1987 look a year from now? Some regulators were predicting that this year probably would see a similar number of failures, but that forecast is not universal.

"At one point, we thought failures in 1987 would be about the same as 1986," FDIC spokesman Steve Katsanos said. "Now, it looks like there'll be a higher number." ■

Failures in 1986 Reach Post-Depression Peak

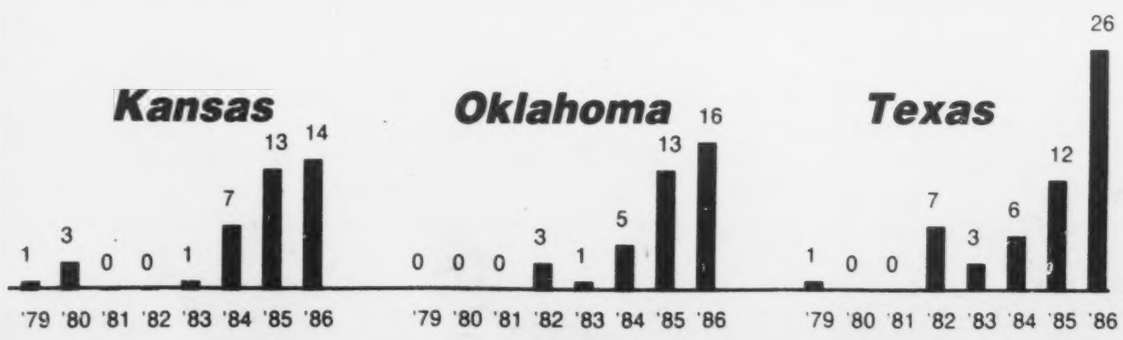


Closed Banks (By State)

	'86	'85	'84	'83	'82
Alabama	1	2	1	1	1
Alaska	1	...	...	...	...
Arizona	...	...	...	...	...
Arkansas	...	1	2	1	3
California	8	7	6	5	2
Colorado	7	6	2	1	...
Connecticut	...	...	...	...	...
Delaware	...	...	...	...	...
Dist. of Columbia	...	...	...	...	...
Florida	3	2	2	...	1
Georgia	...	...	...	...	...
Hawaii	...	...	...	...	...
Idaho	1	...	...	...	...
Illinois	1	2	5	6	5
Indiana	1	1	2	...	...
Iowa	10	11	3	...	2
Kansas	14	13	7	1	...
Kentucky	2	...	1	1	...
Louisiana	8	...	1	...	...
Maine	...	...	...	...	...
Maryland	...	...	...	...	...
Massachusetts	...	...	...	...	1
Michigan	...	...	1	...	1
Minnesota	5	6	4	1	1
Mississippi	...	...	1	...	...
Missouri	9	9	2	1	2
Montana	1	...	...	1	...
Nebraska	6	13	5	1	...
Nevada	...	...	...	1	...
New Hampshire	...	...	...	...	...
New Jersey	...	...	1	1	1
New Mexico	2	3	...	...	...
New York	...	4	...	2	4
North Carolina	...	...	...	...	...
North Dakota	...	...	...	...	...
Ohio	...	...	...	...	...
Oklahoma	16	13	5	1	3
Oregon	1	3	5	5	...
Pennsylvania	...	...	...	...	1
Puerto Rico	1	...	1	1	1
Rhode Island	...	...	...	...	...
South Carolina	...	...	...	...	...
South Dakota	1	...	1	1	...
Tennessee	2	5	11	12	3
Texas	26	12	6	3	7
Utah	3	1	1	...	...
Vermont	...	...	...	...	...
Virginia	...	...	...	...	1
Washington	...	...	...	...	1
West Virginia	...	...	...	...	1
Wisconsin	1	1	...	...	...
Wyoming	7	5	2	1	...
Total	**138**	**120**	**79**	**48**	**42**

The total of failures for 1986 does not include seven assistance transactions. There were two in Kansas and one each in Louisiana, Missouri, Oklahoma, Tennessee, Washington.

Failures Mount for Three Hard-Hit States



Joint Proposal On Capital Rules

Continued from Page 9

als penalize American banks but do not affect U.S. thrifts or foreign banks, with the exception of British institutions.

"If risk-based capital standards make sense," he added, "then banks taking little asset risk should be allowed to go below the existing capital requirements." The Fed wants the risk-based measure to supplement, rather than replace, the existing capital requirement.

Among the top 50 bank holding companies, according to a Federal Reserve staff memorandum, the primary capital-to-assets ratio ranges from 6.1% to 9.2% and averages 7.2%. The staff's estimate of the proposed risk-asset measure ranges from 6.1% to 11.2% and averages 8.1%.

The proposed agreement between the U.S. and England also would aim at a common definition of what constitutes primary capital. In the U.S. the new definition would add preferred stock with a life of more than 25 years to primary capital, for example.

However, goodwill added to a bank's balance sheet could no longer be counted as capital. Existing goodwill would be grandfathered under the proposal.

Although the proposed agreement between the U.S. and Britain contemplates uniform standards, the Fed staff noted in its memo to the board some areas of differing treatment that have not been resolved.

Britain requires, for example, that 100% of a bank's net open foreign exchange position be supported with capital. While Thursday's proposal did not address foreign exchange positions held by U.S. banks, it stressed that "U.S. authorities are committed to developing an approach to incorporating foreign exchange risk into the proposed risk-asset measure."

Smaller Banks, Lower Risks

A risk-based measure of the kind now being proposed would likely affect the nation's big banks, which have large off-balance-sheet exposures and huge credit card portfolios, more than the small banks.

Indeed, since the risk-based measure assigns a lower weight to the kinds of assets that smaller banks are most likely to hold — obligations of the U.S. government, state and municipal debt, and claims on other banks, for example — than it does for commercial and industrial loans, financial guarantees, and claims on foreign borrowers, the risk-based measure could well mean a lower level of capital, in dollar terms, for those institutions.

In its memorandum to the board, the Fed staff declined to set a percentage level for the risk-based measure, although it said it would almost certainly be higher than the current standards of 5.5% for primary and 6% for total capital.

Instead, the board said it will wait until it has some experience in using both measures "in tandem" before deciding upon the appropriate risk-based capital ratio.

Mr. Volcker said that he expects to see comment from banks about the appropriate ratio over the next 90 days — the comment period for the proposal released Thursday — and added that the board is unlikely to seek additional comment when it decides what the ratio should be.

As a practical matter, most small banks maintain capital well in excess of what is required now or would probably be required under a risk-based system. Larger banks have been building capital to levels above the 5.5% requirement, though many banks would likely find themselves below the new standard.

Mr. Volcker said adoption of the risk-based measure would likely change bank behavior, and he suggested that many of the banks that would be affected most would welcome the change.

"Banks are giving away these kinds of services because they feel the market forces them to," he said referring to some of the off-balance-sheet risks, such as letters of credit and interest rate swaps.

Once they are required to back those risks with capital, he said, "I would hope they would implement more rational pricing." ■

Freddie Mac Will Move To New Headquarters

Washington Bureau

WASHINGTON — The Federal Home Loan Mortgage Corp. will break ground later this year for a new headquarters in nearby Tysons Corner, Va., to make room for a burgeoning employee population.

"Our present office space in downtown Washington simply can't accommodate our staffing requirements any longer," said J. David Robinson, vice president of administration and corporate properties.

Mr. Robinson said Freddie Mac increased its work force by 50% to 1,500 in 1986 to handle increased mortgage activity. Nearly 1,050 employees work at the headquarters, and half of them live in northern Virginia, Mr. Robinson said. By the middle of this year, Freddie Mac projects that its staff will reach a total of 1,700 nationwide, with more than 1,200 working at headquarters.

Under the terms of a real estate agreement, Freddie Mac can develop up to 44.5 acres of land near Dulles airport. ■

London Review . . .

➳ **Continued from Page 2**

banks dominate the league tables, or business rankings, accounting for nine of the top 16 lead managers.

The unchallenged leader in both areas was Citibank, which arranged loans and note issuance facilities to the tune of $42.7 billion in 1986 and managed 64 Eurocommercial paper dealerships.

Unfortunately for the banks, commercial paper, syndicated loans, and Eurobonds are not where the profits are these days. The most profitable area in the Euromarkets currently, experts say, is equity and equity-related issues — and here U.S. banks have no presence at all.

A major impediment is the Glass-Steagall Act, which prohibits American banks from underwriting more than $2 million, or 10%, of any international equity issue.

Other important market developments last year included the crash in the market for perpetual floating rate notes. One of the fastest-growing sectors of the market in recent years, this source of primary capital for banks is now all but shut down.

Many investors that have turned away from floating rate notes have turned toward another American import: mortgage securities. The international mortgage market continued to develop in 1986, with U.S. houses such as Salomon Brothers introducing European investors to such exotica as collateralized mortgage obligations. The Euromarkets last year also saw the first securities backed by auto loans and credit card receivables.

Such "set-backed" securities will be a major growth area of the Euromarkets in 1987, experts said.

Thus, the Euromarkets will see growth in 1987, but in selected areas.

Profitability in commercial paper, Eurobonds, and British government gilts will be thin and will depend largely on the skill of the traders. Fatter profit margins will continue to exist in swaps, where U.S. banks are strong, and in equities, where U.S. banks are very weak.

Overall, however, the markets here should remain vitally important to the international financial system in 1987, and large banks, lacking opportunities in traditional lending, should continue to maintain a strong presence here.

"The securitization process that is driving the markets is irreversible, but the growth rates of the business will slow down," said Mr. Band of Morgan Guaranty.

After all, he said, "you can't grow by 50% a year forever." ■

Noninterest Income Still Key to Earnings Growth

➳ **Continued from Page 1**

rate paid on 90-day Treasury bills showed a decline of 145 basis points from the beginning to the end of the year, while federal funds, which are overnight loans between banks, and 30-year Treasury bond rates both fell 135 basis points.

The prime rate, however, dropped a full 200 basis points during the year. The prime has traditionally been the interest rate charged on large commercial loans to a bank's best corporate customers. While it is no longer the rate most widely used by banks to price loans, it is an important measure of how much a bank is earning on its interest-bearing assets.

Banks have traditionally made money on the spread between the interest rates on these funding instruments and the rate they receive on loans made with these funds. Because the lending rate, as shown by the prime, fell more quickly in 1986 than the funding rate, as shown by the rates on T-bills, fed funds, and T-bonds, net interest spreads were squeezed.

Banks might be able to combat these narrower interest rate spreads if lending volume picked up, but that does not seem to be in the cards. Cheryl Swaim, an analyst at Oppenheimer & Co., estimated in a recent report that loan growth would remain steady at 8% in 1987.

But the news may actually be worse than that for many banks. Ms. Swaim says that real estate loan growth has made up for subpar growth in commercial and industrial loan growth in 1986 in many areas.

Because of the overbuilt real estate market in many major metropolitan areas, this growth should peak in 1987. However, Ms. Swaim says, "the continued growth in real estate loans in light of market conditions has negative implications for credit quality."

Also, consumer loans, which have been strong and which offer banks the highest spreads above their funding costs, have shown signs of slower growth recently.

Inflation Outlook

Money center banks can take some consolation from analysts' predictions that 1987 should bring little, if any, worsening of their funding picture. Most economists are predicting that inflation will remain moderate and interest rates will stay flat.

However, banks may be running out of opportunities to boost their income through noninterest income. In the year that just ended, for example, gains on the sale of investment securities were boosted by a continually strong stock market.

But banks may have used up much of their capacity to take these kinds of gains. Also, observers say that many have gone as far as they can in repricing fees for services.

Therefore, noninterest income in 1987 will have to come increasingly from fee-generating businesses that have been set up in recent years, including nonbanking and investment banking subsidiaries.

Merrill Lynch's Mr. Barkocy says that some regional institutions, which depend heavily on retail deposits for their funding, may get something of a break in 1987. With lower interest rates, several companies found they could lower the rate paid on passbook savings accounts, thereby lowering the cost of funds. Major money center institutions that depend largely on wholesale funding sources won't be able to score as large a benefit from that option.

Another difference between regional and money center net income that also benefits the regionals is the progress banks have made in dealing with loan losses.

Analysts project that at major money center institutions, loan-loss provisions will rise about 10% to 20% for the year, with developing-country debt and real estate loans being some of the largest headaches for lenders.

However, many regional banking firms — those that have avoided too much loan exposure to troubled areas such as real estate or energy — will see asset quality improvingin 1987. This could enable some to slow their building of loan-loss reserves and possibly reroute that money directly into earnings. ■

Strategic Dates
July 1, 1987

WASHINGTON INTERSTATE BANKING: A law permitting out-of-state banks to acquire Washington financial institutions that are at least three years old, as long as the acquirer's home state has similar legislation, becomes effective.

Memory Bank

Following are the answers to the Memory Bank Quiz on page 4.

1. Chemical Bank, New York. **Jan. 5, page 1 : column 3.**

2. According to A.M. Best & Co., an insurance rating and analytical agency, the main reason was increased premiums, particularly for commercial liability risks. **Jan. 6, 2:1.**

3. W. Frank Badgett, former president of the Bank of Pilot Mountain, was convicted of misapplying more than $2.6 million of bank funds and concealing bank records that would have detailed his interests in loans to Fit-All Sportswear Inc., a manufacturer. (And the answer to the other question is Frances Bavier.) **Jan. 6, 24:1.**

4. The Federal Asset Disposition Association. **Jan. 7, 1:3.**

5. Lincoln Savings and Loan Association, Irvine, Calif. **Jan. 8, 1:4.**

6. According to an attorney for some of the plaintiffs, in many of the buy-sell transactions, State Savings and Loan Association, which was owned by Financial Corp. and later merged into its American Savings and Loan Association unit, acquired land sought by a developer, who originally had approached the thrift for a property loan. After acquiring the land, State then sold it to the developer at a price that typically approximated 50% of the projected profit of the development after completion. The profit was immediately recognized by Financial, the attorney said. **Jan. 8, 2:2.**

7. A Bank of America logo, the letters "FIB" for First Interstate Bancorp, and the universal "no entry" sign. **Jan. 8, 3:2.**

8. The new definition would add preferred stock with a life of more than 25 years to primary capital. But goodwill added to a bank holding company's balance sheet would have to be deducted from capital. **Jan. 9, 1:2.**

9. Mortgages. Without admitting guilt, the Dime agreed to pay a total of $2.4 million to 1,800 customers to settle a class-action suit. The plaintiffs alleged that the Dime had illegally changed the index of their adjustable-rate loans, resulting in higher interest rates on the loans. Separately, later last week, the New York attorney general announced that the Dime would pay a total of $95,000 in fines because of false advertising on its mortgage products. **Jan. 9, 3:2.** ■

EquiManagement's loan collection guarantee:

If we don't collect your loan, we don't collect from you.

At EquiManagement, we're so good at collecting bad loans, we guarantee results. If you have bad real estate, energy or international loans, or loans in litigation you can't collect, we'll collect them for you. It doesn't matter what we have to do. Just give us a call. We'll make your bad loans good, or you don't pay. We guarantee it.

For a free analysis call Alan Fellheimer at (412) 288-5700.

EquiManagement
An Equimark Company

Two Oliver Plaza, Pittsburgh, Pennsylvania 15222